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IS REVISION DUE OF U.C.C. ARTICLE 9, PART 5?

FRED H. MILLER*

Introduction

No creditor extends credit in contemplation that the debt created ultimately will need to be collected from any collateral that secures repayment.¹ However, inevitably there are a certain number of credit extensions which require resort to the collateral in order to obtain repayment. Part 5 of article 9 of the U.C.C. deals with the rights and responsibilities of the debtor and of the secured party in those circumstances.

Default

The key concept under part 5 of U.C.C. article 9 is "default." Because article 9 of the U.C.C. does not define "default," the security agreement must state when default has occurred. Of course there is no difficulty in contemplating and reaching agreement on certain events as defaults — for example, if there has been a failure to pay as agreed. However, this and whatever else may constitute a default is a matter of agreement between the parties entering into the security agreement. Thus, if a creditor desires that a failure to pay either principal or interest, a failure to keep the collateral insured, a failure to pay taxes on the property that is collateral, or any number of other things should constitute a default, these events must be defined in the security agreement as defaults. If an event is not declared a default in the security agreement, the creditor may not have the right to use that event to invoke a remedy.²

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1. A debt may be collected by the creditor obtaining a judgment and then levying on the debtor's nonexempt assets to force their sale and apply the proceeds to satisfy the judgment. A secured party as a creditor may do this. U.C.C. § 9-501(1), (5) (1989) (unless otherwise noted, all further U.C.C. citations will be to the 1989 official text). See *infra* text accompanying notes 49-54 (section titled *Proceeding as if Unsecured*). A secured party may employ this approach to gain the protection afforded in a court proceeding. However, a contractual security interest granting a claim on described collateral gives the secured party a right by agreement to obtain the collateral, dispose of it, and apply the proceeds to the obligation due without the necessity of judicial proceedings. U.C.C. §§ 1-201(37), 9-503, 9-504.

2. U.C.C. § 9-501(1) states that when a debtor is in default under a security agreement, a secured party has the rights and remedies provided in article 9, part 5 and, except as limited by the statute, those provided in the security agreement. Absent default, it would not appear those rights and remedies are available.

Common events of default specified in many security agreements include:

- any payment provided in the security agreement and in any note is not made when due;
- failure to perform any other obligation, or failure to abide by any other provision, in the security agreement;
- failure to make any payment due or to perform any other obligation in any other transaction between the debtor and the secured party, or any other party;
- if any warranty made to the secured party is breached, or if any representation or financial information given is false;
- if any of the debtor's property is subjected to levy, garnishment or other legal process, or if any interest of the debtor in the collateral is transferred by way of sale, security interest or otherwise without the prior written consent of the secured party;
- if any of the collateral is stolen, damaged or destroyed;
- when in the judgment of the secured party the collateral becomes unsatisfactory or insufficient in character or value and the debtor upon request fails to provide additional collateral;
- upon the death, dissolution, termination of existence or insolvency of the debtor, the appointment of a receiver over any part of the debtor's property, the occurrence of any assignment for the benefit of the debtor's creditors, or the commencement of any proceedings under any bankruptcy or insolvency law against or by the debtor;
- upon the happening of any of the above events to a guarantor of the debt; and
- any time the secured party in its sole discretion believes the prospect of payment or performance is impaired or that the collateral is in jeopardy.

The last event of default listed above is a general catch-all that allows a secured party to proceed even though no *specific* event of default may have transpired. An example might be an attempt by the debtor to sell the collateral to a third party, even though no sale has in fact yet occurred. A creditor should not, however, exercise rights pursuant to a claimed default under this general type of clause unless it reasonably believes a significant risk of nonpayment or loss of collateral exists as shown by prior or general experience. The reason is that all actions to enforce the security agreement must be taken in good faith.³ For example, in *U.S. National Bank v. Boge*,⁴ a bank was actively pursuing foreclosure measures on a farmer's collateral.

3. U.C.C. § 1-203 states that every contract or duty in the U.C.C. imposes an obligation of good faith in its performance or enforcement.

4. 102 Or. App. 262, 794 P.2d 801 (1990). Another illustrative case is *Watseka First Nat'l Bank v. Ruda*, 10 U.C.C. Rep. Serv. 2d (Callaghan) 1073 (Ill. 1990).

The farmer, in order to exercise his right to redeem, needed loan information, which the bank intentionally withheld. Consequently, the farmer was prevented from repaying the loan and retaining the property. In response to the farmer's claim against the bank, the court held that liability could occur even though persons believed their conduct to be justified, and that sometimes more than honesty is required under an implied duty of good faith and fair dealing which supplements the U.C.C. standard of subjective honesty in fact.⁵ While such an analysis may not be possible in some states,⁶ it is arguable that a result similar to that in *Boge* could be reached because it does not appear the bank in that case was even subjectively honest in intentionally withholding information necessary for the debtor to exercise a clear right to redeem.⁷

It also is important to recognize that courts may not always enforce "technical" defaults. For example, in two Oregon cases⁸ the courts held that a lender who is aware that the debtor has consumer credit insurance coverage must ascertain if the debtor has a claim and give the debtor an opportunity to establish eligibility for insurance coverage before repossessing the collateral. Yet other cases demonstrate still further possible dangers in this respect. For example, in *Knittel v. Security State Bank*,⁹ the court held that late payment of a note installment did not constitute a default as a matter of law in light of the statement by an employee of the bank that the installment need not be paid when due.¹⁰ Another case is *Ford Motor Credit Co. v. Goings*,¹¹ where evidence showed an initial intent by the debtors to pay the balance due, but tender of a lesser amount was actually made because the creditor had incorrectly stated the balance due.¹² Subsequent correspondence confirmed the continuing intent and willingness of the debtors to pay the correct balance. The court held that the tender was sufficient under those circumstances, and there could be no resort to the possessory rights of the secured party under the security agreement because there was in fact no default.¹³

Finally, consider two cases, *Klingbiel v. Commercial Credit Corp.*¹⁴ and *In re Winters*.¹⁵ In *Klingbiel*, the secured party accelerated the debt under a clause allowing the party to do so because it felt insecure, but the debtor

5. *Boge*, 794 P.2d at 805-06. U.C.C. § 1-201(19) defines "good faith" only as honesty in fact.

6. See *Rodgers v. Tecumseh Bank*, 756 P.2d 1223 (Okla. 1988) (court refused to find a tortious breach of an implied duty of good faith and fair dealing when lender refused to consider loan renewal or extension even though contract appeared to give a right to refinance).

7. U.C.C. § 9-506.

8. *Carter v. U.S. Nat'l Bank*, 95 Or. App. 305, 768 P.2d 930 (1989); *Owens v. Walt Johnson Lincoln Mercury, Inc.*, 281 Or. 287, 574 P.2d 642 (1978).

9. 593 P.2d 92 (Okla. 1979).

10. *Id.* at 96.

11. 527 P.2d 603 (Okla. Ct. App. 1974).

12. *Id.* at 608-09.

13. *Id.* at 609.

14. 439 F.2d 1303 (10th Cir. 1971).

15. 2 U.C.C. Rep. Serv. 2d (Callaghan) 1733 (Bankr. D. Or. 1986).

was not in default. The secured party did not notify the debtor prior to repossession even though the security agreement provided that the debtor would, after acceleration, pay the amount due upon demand, or, at the election of the secured party, deliver the vehicle. The court held that the secured party was liable for unlawful conversion.¹⁶ In *Winters*, a debtor, after filing a chapter 7 bankruptcy proceeding, continued to make installment payments and to maintain the insurance required to be maintained on the collateral. The court held that the secured party was not entitled to enforce the security interest on the basis of a provision in the security agreement that designated bankruptcy alone as a default.¹⁷

It is clear that the forbearance of article 9 to more precisely regulate the concept of default raises some risk to the secured party and may necessitate expense on the part of the debtor to establish rights, the expense of which in some cases might preclude the effective exercise of those rights. Nonetheless, given the obvious multitude of circumstances in which the question of whether default has occurred may arise, the ability of the parties to provide certainty by agreement, and the regulation by the U.C.C. of some of the consequences of default, the present U.C.C. approach appears to be the preferable one.

Acceleration

After a default occurs, a creditor has the rights and remedies provided in article 9 and, except as limited by statute, in the security agreement. One right universally provided in installment contracts is the right of acceleration.¹⁸ Indeed, if it is not provided the creditor may well have to wait until each installment is due and not paid before a default occurs. Thus, any security agreement and note need an acceleration clause accompanying the default clause. The acceleration clause should provide that upon default the entire obligation becomes due and payable at the creditor's option without need to give notice to the debtor of the exercise of the option. It must be recognized, however, that generally courts do not view acceleration clauses with favor. For example, in *Westinghouse Credit Corp. v. Shelton*,¹⁹ the creditor had consistently accepted late payments before invoking the failure-to-pay clause as a default and accelerating the debt. The court held that the creditor could not suddenly declare default for the next delinquent payment and invoke its consequences without first apprising the debtor of its insistence on strict compliance with the contract.²⁰ The court held this was so even if the contract contained an anti-waiver clause, because that clause itself may be waived.²¹

16. *Klingbiel*, 439 F.2d at 1310.

17. *Winters*, 2 U.C.C. Rep. Serv. 2d at 1734-36. See 11 U.S.C. § 541(c)(1) (Supp. II 1984).

18. The right to accelerate maturity for default for reasons other than failure to pay should be included even in single payment contracts.

19. 645 F.2d 869 (10th Cir. 1981).

20. *Id.* at 873.

21. *Id.* at 873-74.

Clearly, acceleration is likely to impose hardship on a debtor. While there is a right to redeem,²² the right to accelerate is unlikely to be exercised if the default itself is due to financial distress, as a majority of defaults are. It also is clear that few creditors immediately invoke acceleration and its consequences because workout returns usually are superior to the return on collection. Thus, many contracts have grace periods and rights to cure or to reinstate written into them. Even when the contracts do not contain these provisions, the fact pattern in *Shelton*²³ is common, and in many transactions workouts will be arranged. Finally, debtors often default due to circumstances beyond their control and, if given leeway, may be able to cure the default or abide by a restructured agreement. Thus, on balance, there appears to be reason to give the debtor who is likely to be in the inferior bargaining position the legal leverage to move negotiation in the direction of salvaging the transaction, rather than leaving that option with the secured party as the U.C.C. now does.

Perhaps the important question is: How is this change in leverage to be effectuated? In a number of jurisdictions it has been accomplished through separate legislation giving a defined class of debtors the right to cure in appropriate circumstances.²⁴ To the extent this type of legislation represents a response to a largely local concern, this approach is preferable.²⁵ On the other hand, the alternative of providing a similar structure in the U.C.C., either to apply generally but subject to contrary agreement with certain exceptions, or for a defined class of debtors and not subject to contrary agreement,²⁶ is perhaps preferable if empirical research discloses that the law of a substantial number of states affords such protection, or that such a structure uniformly appears in a large majority of contracts. Where a consensus exists, rights and responsibilities should not vary dependent upon geographic happenstance in regard to a national statute such as the U.C.C. This article has not researched this area, but suggests that such a project may be in order in conjunction with the study of article 9²⁷ and any subsequent revision effort that stems from that study.

Rights and Responsibilities Upon Default

When a debtor is in default under a security agreement, the secured party and the debtor have the rights and remedies provided for in article 9, part 5, and in section 9-207, and those provided for in the security agreement.²⁸ For the secured party these are:

22. U.C.C. § 9-506.

23. See *supra* note 19.

24. See, e.g., UNIF. CONSUMER CREDIT CODE §§ 5.109-.111 (1974).

25. See, e.g., Miller, *U.C.C. Articles 3, 4 and 4A: A Study in Process and Scope*, ____ ALA. L. REV. ____ (forthcoming).

26. See U.C.C. § 9-501(3); UNIF. CONSUMER CREDIT CODE §§ 1.107, 5.109-.111 (1974).

27. The study is being conducted by a study committee under the auspices of the Permanent Editorial Board for the U.C.C.. See Miller & Fry, *Introduction to the Uniform Commercial Code Annual Survey: Good News and Bad News*, 45 BUS. LAW. 2281, 2282 (1990).

28. U.C.C. § 9-501(1)-(2).

- a right to reduce the claim to judgment;²⁹
- a right to engage in direct collection;³⁰
- a right to obtain possession of the collateral, to require the debtor to assemble the collateral, and to render equipment that is collateral unusable;³¹
- a right to hold increases in the collateral and to use the collateral within specified limits;³²
- a right to dispose of the collateral and to collect any deficiency;³³ and
- a right to retain the collateral in discharge of the claim within specified limits.³⁴

The secured party's rights and remedies are cumulative.³⁵ However, cases have used some unfortunate language in this regard, indicating that a debtor might have either a claim for harassment or another claim on some other basis when the secured party simultaneously pursues two or more avenues to collect the debt.³⁵ On the other hand, some cases actually have followed their language and limited a secured party's remedies. These decisions are erroneous on the facts involved in those cases,³⁷ and, if article 9 is amended, the present rule as to cumulation of rights and remedies should be restated and clarified.³⁸

The debtor, even after default and the acceleration of the debt, has certain rights as well as responsibilities. For the debtor these are:

- the secured party is liable for conversion if property that is not collateral is taken;³⁹
- a right to have the secured party proceed in accordance with article 9 in a commercially reasonable manner;⁴⁰

29. *Id.* § 9-501(1).

30. *Id.* § 9-502.

31. *Id.* § 9-503.

32. *Id.* § 9-207.

33. *Id.* § 9-504. In some states separate legislation may impose an anti-deficiency rule in consumer credit transactions or only in consumer credit sales of goods or services. *See, e.g.,* UNIF. CONSUMER CREDIT CODE § 5.103 (1974).

34. U.C.C. § 9-505.

35. *Id.* § 9-501(1).

36. *See Farmers State Bank v. Ballew*, 626 P.2d 337 (Okla. Ct. App. 1981). The actual result in *Farmers* is correct regardless of the court's language, and the case probably can be limited to its facts. These facts involved a secured party who held collateral without disposing of it while at the same time suing the debtor on the debt obligation. A secured party cannot deprive the debtor of the use or value of the debtor's property by retaining possession for an unreasonable length of time and not crediting its value against the debt.

37. *See, e.g., Baldwin v. First Nat'l Bank*, 362 N.W.2d 85, 89 (S.D. 1985) (secured party pursued both repossession of some collateral and attempts to collect from account debtors); *City Fed. Savs. Bank v. Florida E. Dev. & Mortgage Co.*, 536 So. 2d 1057 (Fla. Dist. Ct. App. 1988) (secured party sued the makers of certain notes put up as collateral and also the guarantors of those notes).

38. A similar problem has been addressed in the amendments to U.C.C. article 2A, part 5. That draft might provide some guidance.

39. *See Mangrum v. Ford Motor Credit Co.*, 577 P.2d 1304 (Okla. 1978) (evidence in conversion action brought by purchaser of automobile for guns allegedly in trunk when car repossessed failed to establish circumstances necessary for punitive damage liability).

40. U.C.C. §§ 9-502, -504, -507.

- a right to have the secured party use reasonable care in the custody and preservation of collateral in the secured party's possession;⁴¹
- a right to any surplus after the collateral is disposed of and the debt and expenses are paid;⁴²
- a right to due process to the extent applicable⁴³ as to the right to possession;⁴⁴
- a right to notice of disposition;⁴⁵
- a right to force disposition within limits;⁴⁶ and
- a right to redeem.⁴⁷

Many rights or rules protecting the debtor cannot be waived, generally, such as the right to notice of disposition.⁴⁸ Moreover, a substantial number of courts hold that a guarantor is a debtor, and thus the standard waiver that appears in a guaranty may be unenforceable.⁴⁹ Today a wise creditor will treat a guarantor of the debt as a debtor, and any revision of article 9 should clearly adopt this position.⁵⁰

Mixed Collateral

If the security agreement covers both real and personal property (such as a fixture), the secured party may proceed under article 9 either as to the personalty or as to both the real and personal property in accordance with rights and remedies in respect of real property.⁵¹ It is likely that a secured party foreclosing a real estate mortgage that covers fixtures, such as an air

41. *Id.* § 9-207.

42. *Id.* §§ 9-502, -504.

43. *See Helfinstine v. Martin*, 561 P.2d 951, 954 (Okla. 1977).

44. U.C.C. § 9-503.

45. *Id.* § 9-504.

46. *Id.* § 9-505.

47. *Id.* § 9-506.

48. *Id.* § 9-501(3). The rights and rules that cannot be waived, with a few exceptions, are the right to surplus, the rules on disposition, the rules on retention of collateral in satisfaction of the debt, the right to redeem, and the rules on liability. The exceptions are stated in §§ 9-504 through 9-506. The parties, however, may set the standard by which the nonwaivable right or rule is to be measured, so long as the standard is not manifestly unreasonable. *Id.* § 9-501(3). An issue with an unclear answer is whether the parties also may liquidate the damages for a violation of a nonwaivable right or rule. It would seem that, within the parameters defined by U.C.C. § 2A-504 and applied by analogy, this should be permissible. Any revision of article 9 should explicitly cover this matter.

49. *See, e.g., A.L.C. Fin. Corp. v. Ray*, 437 N.W.2d 593 (Iowa Ct. App. 1989) (lease provided lessor could repossess and sell leased equipment without notice (see U.C.C. § 2A-502), but lease was held to be security agreement and neither lessee/debtor nor guarantor could waive notice prior to default). *But see United States v. Lowey*, 703 F. Supp. 1040 (E.D.N.Y. 1989). *See also United States v. Jensen*, 418 N.W.2d 65, 66 (Iowa 1988) (if SBA is secured party, U.C.C. does not apply; however, under the doctrine of *United States v. Kimbell Foods*, 440 U.S. 715 (1979), U.C.C. rule should be chosen as federal common law rule; as a result guarantors were not bound by waiver prior to default of notice of resale of collateral). The Tenth Circuit followed the *Jensen* case in *United States v. Kelley*, 890 F.2d 220, 221 (10th Cir. 1989).

50. Compare the treatment of the owner of collateral who does not owe the obligation under U.C.C. § 9-112.

51. U.C.C. § 9-501(4).

conditioner, a furnace, or wall-to-wall carpeting,⁵² will foreclose its interest in the fixtures in conjunction with foreclosure of the mortgage rather than exercise its right as a secured party to separately remove the fixtures.⁵³ However, even if the collateral is merely goods, this option is available, although it is difficult to contemplate why it would be used unless the goods were integral to the function of the balance of the collateral so that disposition as a unit was desirable, such as the office furniture in a manufacturing plant that is collateral.

If the goods are sufficiently related to the real estate, it may be possible that a secured party has another option as well — to proceed under any statutory lien such as a mechanic's lien. For example, in *O'Dell v. Kunkel's, Inc.*,⁵⁴ a company which installed central heating and air conditioning in a new residence and reserved a security interest in the goods was held also to have a statutory lien remedy unrelated to the U.C.C. remedy and, when enforcing rights and remedies in respect to real property pursuant to that remedy, the provisions of article 9 were held not to apply.⁵⁵

Proceeding as if Unsecured

A secured party may reduce its claim to judgment by obtaining personal jurisdiction over the debtor and suing on the debt claim. When a secured party has reduced its claim to judgment, the lien of any levy on the collateral, by virtue of execution, relates back to the date of perfection of the security interest. A judicial sale pursuant to execution is a foreclosure of the security interest.⁵⁶ Probably the primary reason why a secured party might wish to proceed in this manner, as if the debt was unsecured, is to obtain the protection of court rulings as to proper procedure when the debtor has proven to be litigation-prone.⁵⁷ Of course, the secured party also may purchase at the sale, and thus might obtain the collateral at a very favorable price.⁵⁸

If the secured party seeks judgment on the debt, execution of the judgment and levy on and sale of the debtor's property are not governed by article 9.⁵⁹ However, the act of the secured party in levying or executing on the

52. What are fixtures and their relation to real estate is determined for the most part by laws other than article 9. U.C.C. § 9-313(1)(a), (2).

53. *Id.* § 9-313(8).

54. 581 P.2d 878 (Okla. 1978).

55. *Id.* at 881.

56. U.C.C. § 9-501(1), (5).

57. A disposition of the collateral which has been approved in a judicial proceeding is deemed to be commercially reasonable under U.C.C. § 9-507(2).

58. U.C.C. § 9-501(5). If the price is too low, however, there can be fraudulent transfer problems. This is precluded under the Uniform Fraudulent Transfer Act (UNIF. FRAUDULENT TRANSFER ACT §§ 3(b), 8(e)(2) (1984)), but not necessarily under the Bankruptcy Code (11 U.S.C. § 548 (1988)). Compare *In re Lindsay*, 98 Bankr. 983 (Bankr. S.D. Cal. 1989) (no set aside) with *In re Littleton*, 82 Bankr. 640 (Bankr. S.D. Ga. 1988) (set aside).

59. U.C.C. § 9-501 comment 6; *Farmers State Bank v. Ballew*, 626 P.2d 337 (Okla. Ct. App. 1981).

collateral does not waive the contractual security interest.⁶⁰ Moreover, the right of a secured creditor to take possession does not impose a duty to do so, even if demanded by the debtor. Also, even if the secured party promises to forego legal action, this promise is not enforceable for want of consideration if the debtor promises in return nothing more than it is already legally obligated.⁶¹

Because this method of collecting the debt is likely to be slower and more expensive than other methods, and requires the services of an attorney, it is likely to be used only when necessary. However, it is a useful alternative in some instances.

Foreclosing on Rights to Payments

Suppose a secured party has taken as collateral accounts receivable,⁶² chattel paper,⁶³ a right to payment that is a general intangible,⁶⁴ or instruments,⁶⁵ and the debtor is in default. The secured party might dispose of the collateral to a third party and apply the funds received on disposition to satisfy the debt.⁶⁶ However, article 9 gives the secured party another option.

When so agreed, and in any event on default, the secured party may notify an account debtor (the person who is obligated to pay on an account, chattel paper (lease or installment sale) or general intangible)⁶⁷ or the obligor on an instrument, to make payment to the secured party.⁶⁸ If the transaction involves a secured debt, the debtor is entitled to any surplus from collections and, unless otherwise agreed, is liable for a deficiency.⁶⁹ Under this option, the secured party must proceed in a commercially reasonable manner and may deduct reasonable expenses from the collections.⁷⁰

60. U.C.C. § 9-501(5); *Tax/Invs. Concepts, Inc. v. McLaughlin*, 670 P.2d 981 (Okla. 1982).

61. *Security Bank & Trust Co. v. Cabelka & Sons Custom Harvesting Co., Inc.*, 60 OKLA. B.J. 2495 (Okla. Ct. App. 1989) (unpublished opinion).

62. U.C.C. § 9-106.

63. *Id.* § 9-105(1)(b).

64. *Id.* § 9-106.

65. *Id.* § 9-105(1)(i). All of this collateral essentially involves a payment stream owed to the debtor.

66. *Id.* § 9-504.

67. *Id.* § 9-105(1)(a).

68. *Id.* § 9-502(1).

69. *Id.* § 9-502(2). If the transaction is a sale of accounts or chattel paper, the rule is the converse. *Id.* §§ 9-102(1)(b), -502(2).

70. *Id.* § 9-502(2). To do so in the case of instruments, the secured party may need the endorsement of the debtor on the note or stock certificate or bond. Because a debtor in default may not be cooperative, the endorsement should be obtained when the credit is extended. Furthermore, to collect over any asserted claims to the collateral or defenses to payment may require a status obtainable only if the debtor has endorsed the collateral when it was transferred to secure the credit. *Id.* §§ 3-302, 8-302. Moreover, endorsement in the case of a certificated security should enable the secured party to effectuate effective notice to the issuer. *Id.* § 8-207(1).

A series of other issues may arise. For example, can a secured party exercise, with or without

Repossession

In most instances, upon default and acceleration the secured party will want to obtain possession of the collateral. A debtor in default has little incentive to preserve the collateral, and may overuse it or even try to secrete it.⁷¹ In any event, interest is accruing on a nonproductive extension of credit, and the creditor needs to dispose of the collateral and use the proceeds for repayment as soon as possible.

Unless otherwise agreed, the secured party on default has the right to take possession of the collateral.⁷² In obtaining possession, the secured party may proceed by court action such as replevin.⁷³ Using replevin eliminates the risks inherent in self-help which are discussed below.

A secured party should not dispose of the collateral before conclusion of the replevin action without authority of the court.⁷⁴ A replevin action can be maintained as well as, and in addition to, a real estate foreclosure. Thus, if the creditor's collateral consists of a mortgage on a farm and a security interest in equipment, then foreclosure of the mortgage does not preclude a replevin action under the doctrine of merger, and the creditor is not required to join the real estate foreclosure and replevin actions.⁷⁵

The secured party may proceed without court action if taking possession of the collateral can be done without breach of the peace.⁷⁶ A security agreement authorizing self-help repossession neither involves the waiver of a constitutional benefit in violation of the state constitution, nor violates due process.⁷⁷

agreement, voting rights to compel liquidation of the issuer in order to receive a liquidating distribution? See *id.* § 9-207(4). Is this action a disposition under U.C.C. § 9-504? Is the action within U.C.C. § 9-505? For another example, can a secured party compromise or settle a claim raised by an account debtor? What is required in this regard to proceed in a commercially reasonable manner? Any revision of article 9 should address these issues.

71. This action might constitute a crime. See 21 OKLA. STAT. § 1834 (Supp. 1983).

72. U.C.C. § 9-503. If the security agreement provides for the creditor's right to take possession, and it should, the debtor is required to assemble the collateral and make it available to the secured party. Of course, if the debtor refuses, the secured party will need a court order, and at that point it probably is easier to use replevin, as discussed hereafter. If removal is not elected, a secured party may render equipment unusable, and may dispose of the collateral on the debtor's premises. *Id.* This option also may require a court order to enforce but will be useful when it is not practical to move the collateral. Such action might be taken if, for example, the secured party was foreclosing a mortgage and security interest on a plant and its equipment. Otherwise, the secured party normally will regain possession for the reasons mentioned unless, of course, it already has possession, which would be the case if the collateral is stock or bonds where the perfection requires possession under U.C.C. § 9-304(1).

73. U.C.C. § 9-503. In Oklahoma, the action would normally be replevin. 12 OKLA. STAT. §§ 1571-1585 (1981 & Supp. 1990). Replevin is an action to determine which party has a better right to possession of property. The Oklahoma statute, consistent with due process, allows a reasonably speedy procedure, but it may be subject to delay, is not cheap, and requires the services of an attorney. *Id.*

74. See Miller, *Constitutional Limitations on Repossessions of Personal Property*, 43 OKLA. B.J. 455, 461 n.7 (1972).

75. See *Brenton State Bank v. Tiffany*, 440 N.W.2d 583 (Iowa 1989).

76. U.C.C. § 9-503.

77. *Helffinstine v. Martin*, 561 P.2d 951 (Okla. 1977).

What action by a secured party constitutes valid self-help? Repossession with the debtor's contemporaneous consent is proper, but it is not safe to rely on boiler plate consent included in the security agreement, particularly if the debtor protests at the time of repossession.⁷⁸ Overt consent, however, is not necessary. Thus, in one case, the court held that the secured party did not convert the airplane that was collateral when its agents, without effort to conceal their actions and consistent with the terms of the security agreement, went to an open hanger, entered the airplane by an unlocked door, started the engine, and flew the airplane back to the secured party.⁷⁹ Likewise, a repossession from a driveway, absent the debtor's contemporaneous objection, is not unlawful.⁸⁰ However, entry into a residence, even if unlocked and even under a permissive clause in a security document, is unlawful,⁸¹ as is entry into a closed garage.⁸²

Action to repossess that goes beyond regaining control of the collateral may be determined not to be reasonable. Thus, a bank which had collateral on the debtor's leased premises and which repossessed by utilizing a locksmith to open the locked doors and replace the locks without any public disturbance, nonetheless was held to be guilty of a breach of the peace and thus the repossession was illegal.⁸³

If the debtor is present at the time of the repossession and objects, a repossession of the collateral, even if no altercation results, will be a breach of the peace. A grumbling acquiescence in the taking is borderline; depending on the facts, a court might well find a breach of the peace.⁸⁴ Taking along an off-duty police officer or posing as one to make sure there is no altercation has been uniformly denounced as improper.⁸⁵

Obtaining possession by trick or false representations, such as by posing as a repair service to gain possession of collateral, has been upheld.⁸⁶ However, other cases, at least in their language, cast doubt on whether repossession by trick is lawful. For example, where the secured party induced the debtor to drive to the creditor's office for the ostensible purpose of discussing a delinquent payment schedule, and while the debtor was meeting with the secured party the debtor's car was repossessed from the parking

78. *Hileman v. Harter Bank & Trust Co.*, 174 Ohio St. 95, 186 N.E.2d 853 (Ohio 1962).

79. *Kroeger v. Ogsden*, 429 P.2d 781 (Okla. 1967).

80. *Williams v. Ford Motor Credit Co.*, 674 F.2d 717 (8th Cir. 1982); *Wade v. Ford Motor Credit Co.*, 8 Kan. App. 2d 737, 668 P.2d 183 (1983).

81. *Girard v. Anderson*, 219 Iowa 142, 257 N.W. 400 (1934); cf. UNIF. CONSUMER CREDIT CODE § 5.112 (1974).

82. See *Wilson Motor Co. v. Dunn*, 129 Okla. 211, 264 P. 194 (1928).

83. See *Riley State Bank v. Spillman*, 242 Kan. 696, 750 P.2d 1024 (1988).

84. Compare the majority opinion in *Williams v. Ford Motor Credit Co.*, 674 F.2d 717 (8th Cir. 1982) with the dissent in that case.

85. See *MacLeod v. G & C Inv. Group*, 118 Bankr. 1 (Bankr. D.N.H. 1990); *First & Farmers Bank v. Henderson*, 7 U.C.C. Rep. Serv. 2d (Callaghan) 1305 (Ky. Ct. App. 1988); *Stone Mach. Co. v. Kessler*, 1 Wash. App. 750, 463 P.2d 651 (1970); *Beneficial Finance Co. of Tulsa v. Wiener*, 405 P.2d 691 (Okla. 1965); *Rhodes-Carroll Furniture Co. v. Webb*, 230 Ala. 252, 160 So. 247 (1935).

86. See *K.B. Oil Co. v. Ford Motor Credit Co.*, 811 F.2d 310 (6th Cir. 1987); *North v. Williams*, 120 Pa. 109, 13 A. 723 (1888).

lot, the court held the secured party liable in conversion even though no breach of peace occurred.⁸⁷ The court stated that the law does not allow fraud, trickery, chicanery, or subterfuge as an alternative to judicial process.⁸⁸ Perhaps the case can be explained on the basis that the court saw a high probability for potential violence once the debtor realized the trick, rather than concluding that possession by trick, when there is no potential for violence, is unlawful.

While allowing repossession without judicial process, or without the debtor's voluntary surrender of the collateral, clearly poses some hardship for a debtor (and some risk to a creditor), the case law is sufficiently clear that the benefit of rendering this procedure illegal is not sufficient to outweigh the occasional savings in cost where the debtor has no real defense and is merely playing for time.⁸⁹

Duties While in Possession

"A secured party must use reasonable care in the custody and preservation of collateral in his possession" and is liable for any loss caused by a failure to meet this obligation.⁹⁰ Unless otherwise agreed, the reasonable expenses in doing so are chargeable to the debtor; those expenses are secured, the debtor bears the risk of loss, and the secured party is entitled to any profits as additional security but must apply money received to reduce the debt. The secured party can even repledge the collateral as long as the debtor can still redeem.⁹¹ Finally, "a secured party may use or operate the collateral for the purpose of preserving the collateral or its value," and, except for consumer goods, "in the manner and to the extent provided in the security agreement."⁹²

An illustration of the operation of these provisions is *Kirby v. Horne Motor Co.*⁹³ In *Kirby*, the buyer went to the dealership to redeem a car after it was repossessed, and the buyer had received notice of repossession and of its right to redeem. The dealer had loaned the car to a prospective purchaser for a week, and thus the car was not available. In the resulting suit, the court held that the secured party had not converted the car or otherwise acted improperly.⁹⁴

87. *Ford Motor Credit Corp. v. Byrd*, 351 So. 2d 557 (Ala. 1977). See also *Chrysler Credit Corp. v. McKinney*, 38 U.C.C. Rep. Serv. (Callaghan) 1409 (Ala. 1984). But see *Cox v. Galligher Motor Sales Co.*, 213 S.E.2d 475 (W. Va. 1975).

88. *Id.* at 559.

89. If the debtor has a defense that precludes a default from arising, the repossession will be wrongful even if done without a breach of the peace and the debtor will be entitled to compensation. Thus, the right of a secured party to proceed without court action, as to either a determination of default or the method of repossession, carries the incentive to use due care to avoid liability that will accrue for a wrong determination.

90. U.C.C. § 9-207(1), (3).

91. *Id.* § 9-207(2).

92. *Id.* § 9-207(4).

93. 295 S.C. 7, 366 S.E.2d 259 (Ct. App. 1988).

94. *Id.*, 366 S.E.2d at 262.

Perhaps the usual case litigated under this section is the one involving stock which the debtor believes will increase in value and pay off the loan. Thus, in *Northern Trust Co. v. Burlew*,⁹⁵ when the secured creditor proceeded to sell pledged stock even though its price had consistently declined over a nine-month period and the debtor requested the secured party to wait to see if the price would increase, the court held that the secured party acted properly;⁹⁶ section 9-207 does not impose a duty to attempt to preserve the maximum market value of pledged stock at the secured party's risk.

No undue problems seem to lurk in this provision. The same cannot be said for the next topic.

Disposition of the Collateral

Once the secured party has possession of the collateral, one of three things might happen.⁹⁷ The least likely is that the debtor may pay off the loan and redeem the collateral.⁹⁸ This is because redemption requires payment of the full balance due plus expenses.⁹⁹ A second possibility is that the secured party will retain the collateral in satisfaction of the debt — a sort of “deed in lieu of” result.¹⁰⁰ By far the most common event, however, is that the secured party will dispose of the collateral.¹⁰¹ This can be done in conjunction with court action, as previously discussed in the case of real estate. Alternately, when the secured party obtains judgment on the debt and executes on the collateral, if state procedure allows, it can be done as an adjunct of an action to obtain possession. Even given the extra time and expense, this is a good route to follow if the debtor is inclined to litigate or the collateral is complex or odd, because it affords the protection of a court order.¹⁰² However, the secured party can also elect to dispose of the collateral without judicial action.

The Code tried to give a secured party who elects to proceed without judicial action maximum freedom, in the hope that the freedom would maximize the return received from disposition to the benefit of everyone.¹⁰³

95. 171 Ill. App. 3d 1000, 525 N.E.2d 1123, *appeal denied*, 123 Ill. 2d 560, 535 N.E.2d 403 (1988).

96. *Northern Trust*, 525 N.E.2d at 1126.

97. U.C.C. § 9-503 does authorize disposal of collateral without removal from the debtor's premises but normally the secured party will have possession before further proceedings occur. In some cases, as discussed previously, the secured party can satisfy the debt out of collections from the collateral under U.C.C. § 9-502. Thus, there is a fourth possibility in some cases.

98. U.C.C. § 9-506.

99. *Id.* § 9-506 comment.

100. *Id.* § 9-505.

101. *Id.* § 9-504(1). While, as the Comment to U.C.C. § 9-506 notes, the secured party is not required to dispose of collateral within any stated period of time (except as provided in § 9-505), to fail to do so within a commercially reasonable time will not comply with U.C.C. § 9-504. See *Farmers State Bank v. Ballew*, 626 P.2d 337 (Okla. Ct. App. 1981).

102. Under U.C.C. § 9-507(2), a disposition approved in any judicial proceeding is commercially reasonable. Also, if the collateral is not worth the debt, it produces a judgment that then can be executed against the debtor's nonexempt property.

103. U.C.C. § 9-504 comment 1.

Thus, rather than fixed requirements, which if followed would afford a safe harbor even though they might produce a shocking result in a given case, the standard under the U.C.C. is that the disposition must be “commercially reasonable.”¹⁰⁴ In actual practice this general standard has created a nightmare for secured parties, as courts have often construed it in very technical ways and have devised severe sanctions for breach of the standard, which affords even further incentive for hyper-technical litigation. While some guidance can be derived from the case law interpreting the standard, because fact situations are so diverse, in truth it is difficult to chart a safe course even if the cases are strictly adhered to.¹⁰⁵ In the long run, perhaps the best the statute can do is grant a safe harbor if the disposition is turned over to a professional, such as an auctioneer or a dealer in the goods who knows the relevant market and can document a case for a commercially reasonable disposition.¹⁰⁶ The creditor who sells the repossessed car by putting it in the parking lot with a “for sale” sign on it is asking for trouble, and even letting the creditor’s attorney conduct the sale is asking the attorney to do what an attorney is not trained to do.¹⁰⁷

One further preliminary point should be made. The statute allows the secured party to “sell, lease or otherwise dispose” of the collateral.¹⁰⁸ Thus, for example, if the collateral were intellectual property, presumably the

104. *Id.* § 9-504(3). The “honesty in fact” standard of good faith also is applicable. *Id.* § 1-203.

105. For this same reason, it does not seem possible to devise a statutory safe harbor that would be acceptable in all cases. For example, even if the statute were amended to say that any disposition that brings in excess of 80% of appraised value is commercially reasonable, this would not be acceptable if the collateral in fact could be easily disposed of for 95% of value in a given case. Moreover, other questions would always arise — is this to be retail or wholesale value, and so on. *But see* U.C.C. § 9-507(2) (first sentence). Certainly the North Carolina provisions in this respect do not seem acceptable. One North Carolina provision provides that a disposition by public sale, where the secured party has substantially complied with the procedures, is conclusively deemed to be commercially reasonable in all respects. 6 N.C. GEN. STAT. §§ 25-9-601 to 25-9-607 (1990). However, the procedures essentially are no more than a public auction with notice to the debtor and secured parties as provided in U.C.C. § 9-504(3), and five days advance notice to the public by posting on a bulletin board in the courthouse in the county where the sale will be held. It is unlikely this procedure maximizes any return.

106. Under U.C.C. § 9-507(2), if the secured party either sells the collateral in the usual manner in any recognized market for it, or sells at the price current in such market at the time of sale, or has otherwise sold in conformity with reasonable commercial practices among dealers in the type of property sold, the collateral has been sold in a commercially reasonable manner. *See* U.C.C. § 9-507 comment 2.

107. A bad example that makes this point is *Liberty Nat’l Bank & Trust Co. v. Acme Tool Div. of Rucker Co.*, 540 F.2d 1375 (10th Cir. 1976). The secured party should note that under U.C.C. §§ 1-102(3) and 9-501(3) the security agreement may set the standard by which “commercially reasonable” is to be measured. However, that standard cannot amount to a disclaimer and, unless the security agreement is particularly designed for the specific collateral, the creditor cannot feasibly accomplish a great deal in creating a precise enough standard to furnish a general safe harbor. One place where the agreement may assist, however, is in terms of the timing of notice of disposition, which is discussed later.

108. U.C.C. § 9-504(1).

secured party could license its use, or if the collateral were a plane, the secured party could lease it and apply the collections to the debt, much like a secured party may collect accounts under U.C.C. section 9-502 rather than sell them under U.C.C. section 9-504.¹⁰⁹ However, most dispositions are by sale, and that is where this discussion is focused.

A secured party after a default may sell, lease or otherwise dispose of any or all of the collateral in its then condition or following any commercially reasonable preparation or processing. . . .

. . . .
 . . . Disposition of the collateral may take place in public or private proceedings, may be made by one or more contracts, may be as a unit or in parcels, [and may be] at any time and place and on any terms, but every aspect of the disposition including the method, manner, time, place, and terms, must be commercially reasonable.¹¹⁰

In addition, "[t]he fact a better price could have been obtained . . . is not of itself sufficient to establish [a noncommercially reasonable sale, and if collateral is sold] in the usual manner, in any recognized market . . . or . . . at the price current in such market at the time of his sale [or otherwise] in conformity with reasonable commercial practices among dealers in the type of property sold," the sale is a commercially reasonable one.¹¹¹

Four cases illustrate the types of circumstances where the courts have had trouble with the conduct of the secured party. To illustrate the first circumstance, unreasonable sale procedure, in *Liberty National Bank & Trust Co. v. Acme Tool Division of Rucker Co.*,¹¹² the senior secured party did not dismantle, clean, and repaint the rig that was the collateral, did not move it to a convenient location, and did not employ a professional auction company. The court found the sale was not commercially reasonable.¹¹³ An illustration of the second circumstance, a failure to easily enhance expected return, can be found in *Franklin State Bank v. Parker*.¹¹⁴ In *Parker*, the court found that a sale of a car for junk was unreasonable when fixing the carburetor and replacing spark plugs would have generated a much higher price.¹¹⁵ A third circumstance, the unreasonable option, is illustrated by *United States v. Willis*.¹¹⁶ In *Willis*, the court held that it was not reasonable to hold a procedurally flawless public sale that generated \$41,000 where the

109. This assumes the discounted value of the payments does not have to be applied against the indebtedness. The statute is unclear, but by analogy to U.C.C. § 9-502, this should be the proper answer.

110. U.C.C. § 9-504(1), (3).

111. *Id.* § 9-507(2).

112. 540 F.2d 1375 (10th Cir. 1976).

113. *Id.* at 1382.

114. 136 N.J. Super. 476, 346 A.2d 632 (1975).

115. *Id.*, 346 A.2d at 635. Note U.C.C. § 9-504(1): "in its then condition . . ." However, every aspect of a disposition must be commercially reasonable. U.C.C. § 9-504(3).

116. 593 F.2d 247 (6th Cir. 1979).

creditor had two firm offers, each for \$200,000 or more, and the auctioneer had estimated the public sale would yield only about \$45,000.¹¹⁷ The final illustration, involving inadequate notice, is represented by *Wilkerson Motor Co. v. Johnson*.¹¹⁸ There, the court stated that "the essence of any public sale is that members of the potential class of purchasers have some meaningful opportunity to become apprised of the fact the goods are to be sold," and that a "public sale" advertised by posters posted on two utility poles and on the side of the building at which the secured party then purchased goods did not qualify.¹¹⁹ Does the statute need amendment to provide better guidance in cases like these? It seems unlikely that any amendment can compensate for the lack of common sense and perhaps even good faith that these factual patterns represent. More common sense and not more amendment would seem to be the key.

To illustrate that point, take a case in which the collateral was sold in bulk rather than piece-by-piece because, of six potential buyers who inspected the collateral, only one made a bid, and it was for a sale in bulk. Additionally, the sale was made in a building lighted only by natural light, because to have the electricity turned on would have required payment of past due bills. The sale was found to have been commercially reasonable.¹²⁰

Nonetheless, there are some areas where the statute could well be revised to afford greater guidance. For example, it could be made explicit that a sale at wholesale is commercially reasonable. Cases normally reach this result, because the expenses of selling at retail could offset any price advantage.¹²¹ In one case, *Ford Motor Credit Co. v. Jackson*,¹²² the court held that a wholesale sale was commercially unreasonable, given that the secured party had a closely related network of retail and wholesale outlets, the collateral was in a condition to be sold at retail without repairs, and the likely net return from a retail sale was higher than at wholesale.¹²³ However, the decision in essence required the creditor to compete with its own sales of cars for the benefit of the debtor. Therefore, even on its limited facts, this case should not be followed. Of course, a retail disposition could be made voluntarily, and it should be almost per se commercially reasonable if the secured party chooses that route.

If a retail disposition is made, a trade-in is likely. That fact situation has raised a problem in several cases. In *Elk River Ford v. Hoecherl*,¹²⁴ the buyer had defaulted and the seller resold the truck, giving a generous trade-

117. *Id.* at 259.

118. 580 P.2d 505 (Okla. 1978).

119. *Id.* at 509.

120. *Auer v. Equibank*, 103 Bankr. 700, 703-04 (Bankr. W.D. Pa. 1989). *See also* *First Bank v. Von Eye*, 425 N.W.2d 630 (S.D. 1988) (winter sale of cattle as ordinary cattle justified even though evidence existed that cattle would have brought better price in spring as breeding cattle; spring price was speculative and cost per cow for tests to sell as breeders was \$3 to \$4).

121. *Spillers v. First Nat'l Bank*, 109 Ill. App. 3d 1100, 441 N.E.2d 872 (1982).

122. 126 Ill. App. 3d 124, 466 N.E.2d 1330 (1984).

123. *Id.*, 466 N.E.2d at 1333.

124. 428 N.W.2d 857 (Minn. Ct. App. 1988).

in allowance which operated to increase the deficiency. The court held that there was no basis for objection because trade-ins were normal in such sales.¹²⁵

A retail disposition may also occur because the creditor enforces a recourse agreement or guaranty of the car dealer from whom it acquired the contract. It is important to note that the transaction between the creditor and the dealer cannot set the deficiency. Thus, in *Jefferson Credit Corp. v. Marciano*,¹²⁶ a finance company-assignee tried to recover a deficiency based on the transfer to its dealer-assignor, which had guaranteed payment of the debt. The court held the transfer was not a disposition.¹²⁷

The proceeds of the disposition must be applied to pay reasonable expenses, including legal expenses to the extent provided for in the security agreement (except as limited by law)¹²⁸ or by statute,¹²⁹ the satisfaction of the debt secured, and the satisfaction of any debt secured by a subordinate security interest if written demand was received before distribution of the proceeds.¹³⁰ Generally, if a surplus remains, it must be turned over to the debtor, and the debtor is liable for any deficiency.¹³¹

A substantial problem exists if the disposing secured party is in a second priority position, and the statute needs amendment to cure it. A literal reading of the statute should allow the sale of the collateral subject to the superior lien, and permit the proceeds (the value of the "pledged equity") to be used to pay the second debt it secured.¹³² In fact, the Oklahoma court

125. *Elk River Ford*, 428 N.W.2d at 859. This does not seem a persuasive reason. It is not clear why the deficiency was measured by subtracting the net resale price (gross price less overvalued trade-in) from the amount owed. Presumably the debtor should have been credited with the gross price and the creditor then would obtain the equivalent cash on the resale of the trade-in, as the court suggests. Alternatively, the debtor could have been credited with the actual value of the trade-in plus the unpaid balance of the price after the overvalued trade-in is subtracted from the resale price, as in *Don Jenkins & Son Ford-Mercury v. Catlette*, 59 N.C. App. 482, 297 S.E.2d 409 (1982) and *Thrower v. Union Lincoln-Mercury*, 282 Ark. 585, 670 S.W.2d 430 (1984).

126. 60 Misc. 2d 138, 302 N.Y.S.2d 390 (Civ. Ct. 1969).

127. U.C.C. § 9-504(5) states that such a transfer is not a sale or disposition and the transferee is subrogated to the position of the secured party. The resale at retail could create a surplus that may be due to the debtor. See generally *Ford Motor Co. v. FTC*, 673 F.2d 1008 (9th Cir. 1982).

128. In a consumer loan, for example, title 14A, §§ 3-404 and 3-514 of the Oklahoma Statutes limit any contract by the debtor to pay attorney fees, and § 3-405 limits contracts to pay other default charges but allows reasonable expenses incurred in realizing on a security interest. 14A OKLA. STAT. §§ 3-404, -405, -514 (1981 & Supp. 1990).

129. See, e.g., 15 OKLA. STAT. § 276 (1981); 12 OKLA. STAT. § 936 (1981).

130. U.C.C. § 9-504(1). All subordinate liens as well as security interests are extinguished. *Id.* § 9-504(4). Thus, if no demand is received, the proceeds may be turned over to the debtor, and the lienholder is an unsecured creditor. It would seem reasonable, therefore, to amend the statute to allow a demand not only from a subordinate secured party but also from any subordinate lienholder.

131. U.C.C. § 9-504(2).

132. U.C.C. §§ 9-311, -504(1), -504(4). If the senior secured party, pursuant to notice (see U.C.C. § 9-504(3)) or otherwise, takes over the disposition (as would seem to be its right under §§ 9-503 and 9-504), the proceeds of sale would first have to be paid to the senior

has held that if the subordinate secured party enforces its security interest but the senior lien does not, although the property is sold subject to the senior's lien and the lien of the subordinate secured party is discharged, the proceeds of disposition are still due to the senior lien holder.¹³³ Moreover, and further ignoring the statute,¹³⁴ the court has determined that the second priority secured party is not even entitled to recover the expenses of taking and storing the collateral out of the proceeds of the sale of the collateral.¹³⁵

The moral is clear in states following the Oklahoma position: the second secured party should exercise redemption¹³⁶ and pay off the senior lien and add that amount to its debt, or an advance agreement should be reached with the senior lien holder. However, the statute should be revised to make it clear that either the senior lien holder should be involved in enforcing its security interest or it will have no claim to proceeds of a disposition in which it elected not to become involved.

Notice

By far, the largest amount of litigation occurs and, accordingly, the greatest need to amend the statute exists, in regard to notice to the debtor of the proposed disposition.¹³⁷

Unless collateral is perishable, threatens to decline speedily in value, or is of a type customarily sold on a recognized market,

secured party before any are due to the second secured party (§ 9-504(1)(b) and (c)), and presumably the security interest of the second secured party is extinguished pursuant to § 9-504(4).

133. Consolidated Equip. Sales v. First State Bank & Trust Co., 627 P.2d 432, 438 (Okla. 1981). The court incorrectly focused on priority and not U.C.C. § 9-504(1)(b) and (c) to reach this result, but other courts have agreed. See, e.g., Chadron Energy Corp. v. First Nat'l Bank, 221 Neb. 590, 379 N.W.2d 742 (1986).

134. U.C.C. § 9-504(1)(a).

135. First Nat'l Bank & Trust Co. v. Security Nat'l Bank & Trust Co., 676 P.2d 837, 842 (Okla. 1984).

136. U.C.C. § 9-505.

137. In addition to notice to the debtor (including any guarantor to the extent included within that term (as noted at *supra* note 49)), the secured party, except in the case of consumer goods, must notify any other secured party and, by non-uniform amendment in Oklahoma, any holder of a subordinate lien from whom the secured party has received, before sending notification to the debtor or before the debtor has renounced after default in a signed statement the right to notice, written notice of a claim or an interest in the collateral. 12A OKLA. STAT. § 9-504(3) (1981). As previously noted, because all subordinate liens as well as security interests are discharged under U.C.C. § 9-504(4), and a subordinate lien holder as well as a secured party will have the right to redeem as the holder of a piece of the debtor's "equity" (even though U.C.C. § 9-506 does not provide for that right in the case of a subordinate lien, it should exist outside the Code and be applicable through U.C.C. § 1-103; but see *Frontier Federal Sav. & Loan Ass'n v. Commercial Bank, N.A.*, 62 OKLA. B.J. 1105 (Okla. Ct. App. 1990)), any revision of article 9 should adopt the Oklahoma non-uniform amendment as a matter of fairness. It should be noted that even though these notice provisions are unlikely to satisfy constitutional requirements, little authority would suggest that the constitutional requirements are applicable. See *Helfinstine v. Martin*, 561 P.2d 951 (Okla. 1977); G. NELSON & D. WHITMAN, *REAL ESTATE FINANCE LAW* §§ 7.24, 7.27 (2d ed. 1985).

reasonable notification of the time and place of any public sale or . . . of the time after which any private sale or other intended disposition is to be made shall be sent . . . to the debtor.¹³⁸

Also, “[t]he controlling factor with respect to . . . notification requirements” as to the sale of collateral “is that the notification be sent, and not received.”¹³⁹ For the private sale of collateral, reasonable notification consists of the time after which any sale or other intended disposition is to be made; for a public sale, notice must state the time and place of sale.¹⁴⁰

As to the details of notice, the statute generally needs amendment to conform to those cases that demonstrate good sense and restraint. For example, in *First State Bank v. Perryman*,¹⁴¹ the debtor received proper notice of public sale, and, after no bids were obtained, the secured party sold the collateral in a private sale without further notice. The court looked beyond technicalities to substance and held the first notice was adequate,¹⁴² but this is a minority view. The other view is represented by *Spillers v. First National Bank*¹⁴³ where a notice of private sale was given, but ten days after the date of the notice the deal fell through. The secured party obtained a buyer a month later after seeking other buyers but did not give a new notice. The court held that the first notice was stale.¹⁴⁴

How far in advance must notice be given? The parties can set this by agreement if a reasonable period is chosen.¹⁴⁵ Most security agreements

138. U.C.C. § 9-504(3). Notice need not be given to the debtor if the debtor after default has signed a statement renouncing the right to notification, or need be given only as modified by such a statement.

139. *Beneficial Fin. Co. v. Young*, 612 P.2d 1357, 1358 (Okla. 1980). Use of the word “sent” suggests written notice is required and oral notice is not sufficient. This probably is a desirable rule to keep, although it should be recognized that if a secured party can prove the debtor actually had notice, the debtor should be estopped to deny notice under U.C.C. § 1-103. *Compare* *Crest Inv. Trust v. Alatzas*, 264 Md. 571, 287 A.2d 261 (1972) (oral notice sufficient on facts) *with* *Executive Fin. Servs. v. Garrison*, 722 F.2d 417 (8th Cir. 1983) (emphasizing the policy behind requiring written notice).

140. U.C.C. § 9-504(3); *First Nat’l Bank & Trust Co. v. Holston*, 559 P.2d 440 (Okla. 1976). The Oklahoma court expanded on the literal requirements of the statute by requiring the notice of a public sale also to state a date for the sale, the method of sale, and a description of the collateral, in addition to the time and place of sale. One would think a valid notice would have to do this in any event, as a notice of private sale, as applicable, should include these facts as well as the appropriate statement as to time. The Oklahoma court has done no more than articulate a common sense approach the secured party should use and which any amended statute should adopt. Perhaps a fuller and thus more sensible set of statutory requirements might curtail the tendency some courts have exhibited to embellish the statute. *See, e.g.*, *General Elec. Credit Corp. v. Lewis*, 432 N.W.2d 27 (Neb. 1988) (notice to guarantor as debtor that did not state guarantor was potentially liable for a deficiency was defective).

141. 746 P.2d 706 (Okla. Ct. App. 1987). The courts following this view consider that the notice tells the debtor the time after which it may not be possible to redeem, and thus no new notice is required. This reflects the substance of the law.

142. *See also* *Brown v. Ford*, 280 Ark. 261, 658 S.W.2d 355 (1983) (private sale 16 months after notice).

143. 81 Ill. App. 3d 199, 400 N.E.2d 1057 (1980).

144. *Id.*, 400 N.E.2d at 1060.

145. U.C.C. §§ 1-102(3), 9-501(3).

select five to ten days. One court has held that a minimum of three business days is required so that the debtors can protect their interests.¹⁴⁶ It would seem beneficial for any revision of the statute to provide a safe harbor rule in this regard.

No notice is required in certain instances.¹⁴⁷ One case, *Northern Commercial Co. v. Cobb*,¹⁴⁸ noted that the sale of a used car qualified as collateral that is of a type customarily sold on a recognized market because the Blue Book creates an industry standard for used car prices.¹⁴⁹ This is a minority view and one which the statute should be amended to negate. The statute should clarify that the exception basically is limited to stock, commodities, and the like, in which market forces rather than negotiations determine price.¹⁵⁰

Finally, certain kinds of collateral may involve considerations beyond article 9. Securities are a good example. Under a Securities Exchange Commission rule,¹⁵¹ a pledgee of restricted securities may sell them without compliance with registration provisions if the combined holding period of the pledgor and the pledgee is at least three years and the pledgee has not been an affiliate of the issuer for at least three months.¹⁵² Such matters need not be addressed in article 9, but some illustrative examples in the Comment might well serve a useful function.¹⁵³

Purchasers

The sale of the collateral may be by either a public or private sale.¹⁵⁴ "The secured party may buy at any public sale, [but may not purchase at

146. *DeLay First Nat'l Bank & Trust Co. v. Jacobson Appliance*, 196 Neb. 398, 243 N.W.2d 745 (1976).

147. Under U.C.C. § 9-504(3), this is true when the collateral is perishable or threatens to decline in value speedily. This seems clear enough, particularly if the security agreement addresses the issue where the collateral may be of this type. The problems have arisen with the phrase: "is of a type customarily sold in a recognized market." *Id.*

148. 778 P.2d 205 (Alaska 1989).

149. *Id.* at 211.

150. *But see* *Mercantile Bank & Trust v. Cunov*, 749 S.W.2d 545 (Tex. Ct. App. 1988). The debtor pledged stock in a closely held company which, after default, the secured party sold to itself in a private sale. The court held that the collateral was not of a type customarily sold in a recognized market. *Id.* at 548. *See also* *Wippert v. Blackfeet Tribe*, 215 Mont. 85, 695 P.2d 461 (1985) (cattle).

151. 17 C.F.R. § 230.144(K) (1990).

152. *See also* *Shearson Lehman Hutton Holdings v. Coated Sales, Inc.*, 697 F. Supp. 639 (S.D.N.Y. 1988) (pledgee may sell pledged securities even though insider pledgor had material, non-public information about issuer).

153. Compare the comments to revised U.C.C. article 4, which point out the numerous points of intersection between that statute and federal regulation CC, 12 C.F.R. pt. 229 (1990). The comments to any amended statute also might indicate the applicability of other common doctrines; for example, that the equitable doctrine of marshalling is applicable to dispositions under article 9 through U.C.C. § 1-103.

154. As to what is a public sale, see *Lloyd's Plan v. Brown*, 268 N.W.2d 192 (Iowa 1978). The choice of which method is used is governed by the "commercially reasonable" standard. *Old Colony Trust v. Penrose Indus.*, 280 F. Supp. 698 (E.D. Pa.), *aff'd*, 398 F.2d 310 (3d

a private sale] unless the collateral is of a type customarily sold in a recognized market or is of a type which is the subject of widely distributed standard price quotations.”¹⁵⁵ The term “standard price quotations” probably does not include the “book value” of used cars for the reason discussed in connection with this exception to the requirement of notice. An obvious example of a private sale at which the secured party may be the purchaser would be the sale of stock or bonds sold on the New York Stock Exchange.

A person who purchases the collateral at a disposition after default gets whatever rights the debtor had to that property, free from the security interest of the secured party who sells and from all interests junior to the secured party.¹⁵⁶ The purchaser also takes free from any defects in the way the property was sold if, at a public sale, the purchaser did not know of the defect in the procedure and did not act in collusion with any of the persons involved in the sale. If the disposition was not by public sale, the purchaser will be protected if acting in good faith.¹⁵⁷

Keeping Collateral in Satisfaction

In all cases except those in which consumer goods are involved, a creditor always may propose to keep the property in satisfaction of the debt.¹⁵⁸ In the case of a loan secured by consumer goods in which the debtor has

Cir. 1968).

Disposition may be by way of one or more contracts and as a unit or in parcels. U.C.C. § 9-504(3). These matters, too, should be governed by the “commercially reasonable” standard. Thus, for example, if the best disposition for the insolvent estate of a debtor is the sale of all property as an entirety, it is arguable if the secured party asserts its right to sell the property in which it has a security interest separately that may not represent a commercially reasonable disposition, at least as long as the secured party will not be prejudiced. *See also id.* § 9-507 comment 1.

155. U.C.C. § 9-504(3). *See also supra* text accompanying note 150. If there is a difference between these two standards as interpreted by the courts it is an obscure one at best. Any revision of the statute might do well to better articulate one test.

156. U.C.C. § 9-504(4). Collateral cannot be sold free of a nonconsenting senior lien, however. Moreover, if the debtor never had any rights because, for example, the property was stolen, the purchaser can acquire no rights. As to cases where the debtor had voidable title or was a lessee, see U.C.C. §§ 2-403(1), 2A-307(1).

157. *Id.* § 9-504(4). “Good faith” means honesty in fact. *Id.* § 1-201(19). Of course, the purchaser may be subject to an overriding rule of law, such as the fraudulent transfer provisions of the Bankruptcy Code. 11 U.S.C. § 548 (1988). Whether similar state provisions would apply is unclear (see U.C.C. §§ 1-103 and 1-104), but at least under the Uniform Fraudulent Transfer Act transfers resulting from the enforcement of a security interest in compliance with article 9 basically are shielded. UNIF. FRAUDULENT TRANSFER ACT §§ 3(b), 8(e)(2) (1984). Furthermore, a fundamental defect in the sale might be held to render it void, and supplement the Code rule under U.C.C. § 1-103. For example, under mortgage law the absence of default is fatal. *See, e.g.,* Wellman v. Travelers Ins., 689 P.2d 1151 (Colo. Ct. App. 1984) (sale void where debt deemed previously satisfied), *rev’d on other grounds*, 721 P.2d 685 (Colo. 1986). Any revision of article 9 should send a clearer signal as to whether the purchaser or the debtor is to bear this sort of risk.

158. U.C.C. § 9-505(2).

repaid 60% or more of the loan¹⁵⁹ before default, or of a purchase money security interest in consumer goods in which the debtor has paid 60% or more of the cash price before default, a creditor who has possession of the collateral¹⁶⁰ may not keep the collateral unless the debtor waives the right, in writing after default, to compel disposition.¹⁶¹ In the case of consumer goods which cannot be kept, the creditor must dispose of them within ninety days of the date of obtaining possession of them, or the creditor will become liable for the market value of the collateral, and, if such value exceeds the amount of the indebtedness, the creditor will be liable to the debtor for the excess.¹⁶²

If the secured party is entitled to and decides to keep the collateral, the party must send a notice to that effect to the debtor if the debtor has not signed, after default, a statement renouncing or modifying the right to notice. "In the case of consumer goods, no other notice need be given. . . . In [all] other cases, notice also must be sent to any other secured party"¹⁶³ who has a security interest in the same collateral and who gives the foreclosing secured party written notice of such claim before the foreclosing secured party has sent notice to the debtor or the debtor renounces its rights under this provision. This notice must state that the creditor proposes to keep the collateral in satisfaction of the debt. If no written objection is received within twenty-one days after the notices are sent, the collateral may be retained in satisfaction of the debt. If objection is received, the secured party must dispose of the collateral.¹⁶⁴ This election of strict foreclosure bars the secured party from seeking a deficiency judgment.¹⁶⁵ However, in one case, *Brunzell Construction Co. v. Smith*,¹⁶⁶ in which the secured party obtained a judgment but never sold the collateral, the court upheld a stipulation between the debtor and the secured party, entered into after

159. Presumably this means principal and not interest to be consistent with the rule for purchase money security interests which uses 60% of the cash price. These rules presume a disposition will bring enough to return a surplus to the debtor; thus, to allow the creditor to retain the collateral would result in a windfall.

160. Some states may have anti-deficiency statutes that will control in this case under U.C.C. § 9-203(4). The provision in the Uniform Consumer Credit Code is integrated with the U.C.C. UNIF. CONSUMER CREDIT CODE § 5.103(2)-(4) (1974).

161. U.C.C. § 9-505(1).

162. *Id.* Alternatively, the debtor may hold the creditor liable under U.C.C. § 9-507(1). It is not clear why the statute provides this dual remedy, which has prompted the courts to conclude that the perfectly adequate remedy in § 9-507(1) is not exclusive. A revision of article 9 would serve the cause of certainty to provide one overall remedy for the failure of the secured party to proceed in compliance with article 9.

163. U.C.C. § 9-505(1). Oklahoma amended this provision to provide for notice in addition to any holder of a subordinate lien who sends the secured party a written notice of claim. These notice requirements raise an issue under U.C.C. § 9-505 that needs clarification. Presumably, the secured party keeps the collateral subject to any senior lien. Yet are subordinate liens cut off, as under § 9-504(4)? The statute is silent. If not, why are they entitled to notice and to object?

164. U.C.C. § 9-505(2).

165. *Tanenbaum v. Economics Laboratory*, 628 S.W.2d 769 (Tex. 1982).

166. 200 Cal. App. 3d 617, 246 Cal. Rptr. 182 (1988).

default, providing for a deficiency claim on the ground that after default the debtor could waive rights under this section.¹⁶⁷ There also is authority that possession by the secured party plus use or failure to sell constitutes an implied election under this section.¹⁶⁸

Redemption

Unless the right has been waived after default, before the secured party has entered into a contract for the disposition of, or has disposed of, collateral, or discharged the debt under U.C.C. section 9-505, “the debtor or any other secured party may . . . redeem the collateral by tendering fulfillment of all obligations secured”¹⁶⁹ This includes expenses, and the entire balance must be tendered if a clause allowing acceleration of the unpaid balance upon default has been exercised, absent contrary agreement or law.¹⁷⁰ The effect of an “unconditional tender to a creditor of [the] amount of [the] debt [is] to extinguish [the] lien on [the] personal property pledged to secure its payment where [the] tender is made by one clearly having [a] legal right to make the tender.”¹⁷¹ Thus, a secured party should not attempt to deal with the collateral in any way that does not recognize the debtor’s right to the property after tender is made.

Liability for Noncompliance

If it is established that a secured party is not proceeding in accordance with article 9, part 5, disposition may be ordered or restrained, or an appropriate party (this can be the debtor, a junior secured party entitled to notice of disposition, or a secured party whose security interest has been made known)¹⁷² may recover any loss caused by a failure to comply. If the

167. Note that the prohibition on waiver in U.C.C. § 9-501(3) is qualified by this section.

168. See, e.g., *In re Boyd*, 73 Bankr. 122 (N.D. Tex. 1987). See also *Whirlybirds Leasing Co. v. Aerospatiale Helicopter*, 749 S.W.2d 915 (Tex. Ct. App. 1988) (disposing of collateral in other than a commercially reasonable manner [here the collateral, which had little value except as scrap, was donated by the secured party but without notice to the debtor] in effect is election to retain the collateral in full satisfaction; a deficiency is thus lost). There would seem little reason to overrule the *Boyd* rule in any statutory redraft, but if a unitary remedy is to be formulated for certainty (as discussed in *supra* note 162), cases like *Whirlybirds* must be repudiated.

169. U.C.C. § 9-506. Under equitable principles, any interest holder from the debtor has an equal right to redeem from the lien. See, e.g., G. NELSON & D. WHITMAN, *supra* note 137, § 7.2. This principle presumably supplements U.C.C. § 9-506 through U.C.C. § 1-103, but any revision of the statute should make the point clear.

170. U.C.C. § 9-506 comment.

171. *Ivey v. Henry’s Diesel Serv.*, 418 P.2d 634, 637 (Okla. 1966).

172. Presumably the standard is actual knowledge and not notice from filing or otherwise. U.C.C. § 1-201(25). Interestingly, Oklahoma excludes subordinate lienholders here, even though they may be entitled to notice of disposition under Oklahoma’s non-uniform amendment to U.C.C. § 9-504(3). 12A OKLA. STAT. § 9-504(3) (1981). This well demonstrates the normal folly of non-uniform amendments. Surely a subordinate lienholder who is prejudiced by the improper actions of a secured party, particularly if known to the secured party, is likely to have legal recourse for loss sustained under principles of law not displaced by U.C.C. § 9-

collateral consists of consumer goods, a statutory formula for measuring loss is provided.¹⁷³

Courts have not applied this remedy exclusively, but often instead have denied a deficiency or presumptively denied a deficiency.¹⁷⁴ In Oklahoma the court, in *Beneficial Finance Co. v. Young*,¹⁷⁵ held that noncompliance does not require forfeiture of the right to a deficiency judgment; rather, the debtor has the right to recover damages for noncompliance.¹⁷⁶ That damage may be measured by U.C.C. section 9-507(1) in the case of consumer goods at the debtor's election, or by the value of the property wrongfully proceeded against, because, in essence, a secured party who repossesses and sells improperly has engaged in tortious conduct.¹⁷⁷ What this measure means is illustrated in *Consolidated Equipment Sales v. First State Bank and Trust Co.*¹⁷⁸ In that case, the value of the collateral at repossession was \$20,000 because it was in poor condition. The secured party repaired the collateral, expending \$5,800, and then sold it for \$28,400. Evidence indicated that the value of the collateral after repair was \$32,000. The court found conversion liability of \$26,200 (\$32,000 minus \$5,800) and not \$20,000.¹⁷⁹

If any one issue under article 9, part 5, strongly supports the need for revision, it is this issue. It is suggested that the Oklahoma approach is a logical, fair and practical model for the revision to follow and can be accomplished by simply stating that the loss caused by the failure to comply is the value of the collateral.¹⁸⁰ Of course, the amount of the debt is then set-off before the net recovery is awarded to one party or the other.

507(1), which does not even address the issue. Under the Oklahoma amendment this simple proposition could be (but should not be) interpreted to be in doubt. See *Frontier Federal Sav. & Loan Ass'n*, 62 OKLA. B.J. 1105 (Okla. Ct. App. 1990) (so interpreting 39-507 as enacted in Oklahoma).

173. U.C.C. § 9-507(1). The statute probably should clarify that a secured party seeking a deficiency based on the difference between the unpaid debt and the proceeds of disposition has the burden of proof of compliance with article 9, part 5, because the secured party is in the best position to establish that the steps taken were commercially reasonable. This should still be true even if the action is instituted by the debtor. See J. WHITE & R. SUMMERS, *UNIFORM COMMERCIAL CODE* § 25-16 (3d ed. 1988). If the secured party fails to prove compliance, however, as this article suggests *infra*, the result should not preclude a deficiency; rather the debtor should then have the burden of establishing the loss from the failure in the manner suggested because the debtor is in the best position to determine this fact.

174. See J. WHITE & R. SUMMERS, *supra* note 173, § 25-16 to -19.

175. 612 P.2d 1357 (Okla. 1980).

176. *Id.* at 1359.

177. *Davidson v. First Bank & Trust Co.*, 609 P.2d 1259, 1261-62 (Okla. 1976). Oklahoma is not alone in this approach. See, e.g., *Warren v. Ford Motor Credit Co.*, 693 F.2d 1373 (11th Cir. 1982); *Davis v. Huntsville Prod. Credit Ass'n*, 481 So. 2d 1103 (Ala. 1985); *Day v. Schenectady Discount Corp.*, 125 Ariz. 564, 611 P.2d 568 (Ariz. Ct. App. 1980); *Steichen v. First Bank Grand*, 372 N.W.2d 768 (Minn. Ct. App. 1985).

178. 627 P.2d 432 (Okla. 1981).

179. *Id.* at 438.

180. Of course, a consumer debtor alternatively could elect to measure loss by the statutory formula of U.C.C. § 9-507(1). Because the value of the collateral should not be hard to

Any revision also should make it clear that liability may include consequential or punitive damages if the loss is foreseeable or the conduct is egregious enough. This is the rule under present law. Thus, in *Hemken v. First National Bank*,¹⁸¹ in which a tractor was repossessed and the debtor showed that he could have redeemed the tractor if notice of resale had been given, the debtor was held to be entitled to recover profits that were lost due to the repossession of the machine.¹⁸² Additionally, in *Mitchell v. Ford Motor Credit Co.*,¹⁸³ the Oklahoma court held that the creditor was liable in conversion for repossessing the collateral when the debtor was not in default.¹⁸⁴ The court also held that punitive damages were properly awarded when the evidence showed that the creditor was indifferent to the consequences of its actions and demonstrated a reckless disregard for the rights of the debtor.¹⁸⁵ The court awarded actual damages of \$843.74 and punitive damages of \$60,000.00.¹⁸⁶

Conclusion

On the whole, article 9, part 5, handles a complex area very well. Clearly, there are numerous small issues that could be eliminated or clarified by statutory revision, and several large ones that argue strongly for revision, such as the right of a foreclosing second lienor to the proceeds of disposition and the remedies available against a secured party that is proceeding in a commercially unreasonable manner. Probably, however, the overall need for revision of article 9 is not established by the matters discussed in this article alone, but rather depends on the difficulties posed by part 5 of article 9 in combination with those posed by other parts of article 9 and that are discussed in other articles in this symposium and in other forums.¹⁸⁷

establish, this approach should remove much of the incentive that is behind present case law diversity to locate a remedy that is fair to debtors and practical, and which thus eliminates worries over the burden of proof as to the amount of loss. Note that this approach also is consistent with the remedy presently provided in U.C.C. § 9-505(1). However, it does guarantee the debtor more than full compliance with part 5 would, and in many cases it would be hard to justify this "penalty." Thus, perhaps, overall a better rule might be the rule that the collateral is presumed to be worth the amount of the debt. *See supra* note 174.

181. 76 Ill. App. 3d 23, 394 N.E.2d 868 (1979).

182. *Id.*, 394 N.E.2d at 872.

183. 688 P.2d 42 (Okla. 1984).

184. *Id.* at 45.

185. *Id.* at 46.

186. Footnote 5 to the opinion is dicta and states that a creditor's good faith belief in default or insecurity will be judged by an objective standard based on commercial reasonableness. This is in error given U.C.C. § 1-201(19), and perhaps is now overruled by *Rodgers v. Tecumseh Bank*, 756 P.2d 1223 (Okla. 1988).

187. *See, e.g.,* Weise, *U.C.C. Article 9 — Personal Property Secured Transactions*, 45 BUS. LAW. 2475 (1990); *see also* the annual surveys as to article 9 developments in *The Business Lawyer*.

